



**UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
REGION 8**

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March 2, 2023

Ms. Lindsey Krywaruchka
Water Quality Division Administrator
Department of Environmental Quality
1520 East 6th Avenue
PO Box 200901
Helena, MT 59620-0901

Dear Ms. Lindsey Krywaruchka:

The U.S. Environmental Protection Agency, Region 8, has conducted an annual review of the Montana Water Pollution Control State Revolving Fund (WPCSRF), also referenced as the Clean Water State Revolving Fund (CWSRF) for State Fiscal Year (SFY) 2022 (July 1, 2021 through June 30, 2022) in accordance with the EPA's SRF Annual Review Guidance. Federal Fiscal Year (FFY) is referenced in some locations. FFY 2022 references (October 1, 2021 through September 30, 2022). CWSRF funds utilized during SFY22 were predominantly from the FFY21 or prior grants.

The grantee is the Montana Department of Environmental Quality (DEQ). Duties include developing the Intended Use Plan (IUP) and Project Priority List for the CWSRF program and serving as project managers that work with communities on planning, design, and construction of projects. The required 20 percent state match is provided primarily through the issuance of state match bonds issued by the Montana Department of Natural Resources and Conservation (DNRC). Another source of CWSRF match has been fees earned on CWSRF assistance. The Montana DNRC performs financial management duties of each SRF, working with loan recipients on financial and audit issues, and coordinating an annual financial audit of the CWSRF program.

This annual review summarizes EPA Region 8's evaluation of the technical, financial, legal, managerial, and operational capabilities and performance of DEQ and DNRC in administering the CWSRF. Activities incorporated into the annual review were an analysis of the FY22 and FY23 IUPs, unaudited financial statements, files for two projects (City of Missoula-Caras Park and Twin Bridges), four cash draws listed below, Unliquidated Obligations (ULOs), information logged into the EPA Headquarters SRF Data System and Montana's CWSRF financial indicators. The EPA conducted an in-person annual review of both SRF programs December 5-6, 2022.

CS300001-20 (CA); 7/21/2021; \$79,311 (loan fund)
CS300001-20 (CA); 3/9/2022; \$140,000 (loan fund)
CS300001-21 (CA); 9/14/2021 \$18,318 (4% admin)
CS300001-21 (CA); 1/26/2022 \$1,203,301 (loan fund)



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OBSERVATIONS: The state of Montana managed its CWSRF program during SFY22 in accordance with applicable statutes, regulations, and guidance. The Montana CWSRF continues as a high-performing revolving loan fund that is committing and then using all funds for projects in a very timely manner. The state continues to experience strong wastewater treatment project demand, driven in part by more stringent water quality standards requiring advanced treatment works. The indicator “Ratio of Undisbursed Funds to Disbursements” shows the Montana CWSRF continues to use all funds in less than one year, an outstanding achievement.

The state funded a net of \$21.9 million in new water quality projects from its CWSRF in SFY22. Of the \$21.9 million, \$16.3 million went towards advanced treatment, \$0.3 million went to secondary treatment, \$2.8 million went towards sewer system rehabilitation and Infiltration/Inflow, \$0.9 million went towards new interceptors, \$0.7 million went towards grey stormwater infrastructure, and \$1.0 million for agricultural cropland best management practices.

In November 2021, the Bipartisan Infrastructure Law (BIL) was signed into law, which appropriated additional federal CWSRF funding for FFY22-FFY26 through two types of CWSRF infrastructure grants: supplemental and emerging contaminants (EC). In March 2022, EPA issued BIL Implementation Guidance with the following FFY22 allotments for Montana:

CWSRF BIL Supplemental: \$8,738,000

CWSRF BIL Emerging Contaminants: \$459,000

The first CWSRF supplemental grant funded through BIL utilizes the FFY22 allotment. This FFY22 supplemental grant was awarded to Montana for the full \$8,738,000 on September 1, 2022. The emerging contaminants grant has not yet been applied for or awarded. Montana CWSRF is currently determining how to best utilize these funds and is considering transfer of the 2022 CW EC grant funds to the Drinking Water EC grant fund.

Throughout the five years of BIL implementation, EPA expects Montana to:

- Evaluate and revise, as needed, its CWSRF affordability criteria;
- Evaluate the CWSRF’s priority point system for project ranking commensurate with need;
- Consider technical assistance funding; and
- Engage residents and community stakeholders in disadvantaged communities.

Unliquidated Obligations

As of June 30, 2022, the Montana CWSRF had \$3.7 million remaining in ULOs resulting in a 99 percent outlay rate and a great achievement. Throughout the life of the program, up to June 30, 2022, the state was awarded \$251 million in capitalization grants funds and has disbursed \$247 million.

Green Project Reserve

In SFY22, the Montana CWSRF funded a \$1.0 million loan through DNRC to pay for agricultural cropland best management practices. These projects focus primarily on irrigation efficiency improvements. This project enabled the state to meet its Green Project Reserve (GPR) requirement for the FFY22.

Additional Subsidy

The Montana CWSRF initiated ten assistance agreements in SFY22. Of those agreements, additional subsidy, in the form of principal forgiveness, was provided to three communities, totaling \$600,000. Additional subsidy was attributed to the FFY20 grant, meeting the required 7%. The CWSRF has also met its additional subsidy requirements for all other prior grants.

To prepare for the increased additional subsidy requirements for future grants, the CWSRF program has designated an allowance for loan forgiveness in the amount of \$5.3 million. BIL grant funds require states to provide 49% of the capitalization grant as additional subsidization in the form of principal forgiveness or grants. For SFY23, additional subsidy for each individual assistance agreement in the form of principal forgiveness will be capped at \$750,000 or 35% of the long-term SRF loan using base capitalization grant funds, whichever is less. For the BIL supplemental capitalization grant, the principal forgiveness for each individual assistance agreement will be capped at \$750,000 or 49% of the long-term SRF loan.

The CWSRF program provides additional subsidy to communities as principal forgiveness. The program has expanded its affordability criteria to include the following five criteria in SFY23:

- (1) Communities with the highest user rates relative to median household income,
- (2) Communities with unemployment rates higher than 150% of the state average,
- (3) Communities with changing population trends, either increasing at more than 1.5% or decreasing at more than 0.25% ,
- (4) Additional consideration for communities with a population less than 10,000, and
- (5) Disadvantaged communities will be further identified using percent Low Moderate Income (LMI) data.

Equivalency

For equivalency, Montana will continue to fund projects to meet its FFY22 and FFY23 grant requirements and has met equivalency requirements for all prior grants. The CWSRF program generally references equivalency projects as “first round” projects in their annual reports. However, the CWSRF program has managed all projects to meet the full federal requirements of equivalency, including federal crosscutter regulations and American Iron and Steel requirements. In future Annual Reports, “Equivalency” projects will need to be specifically designated. Other projects, funded by recycled funds and state fees need not meet the full federal project requirements for equivalency.

CWSRF Project Progress

For more traditional measures, the CWSRF is summarized below with the following table, which presents fund use rate and pace of construction at the end of SFY22.

Montana CWSRF Program Summary (\$ Millions)				
CWSRF Funds Available for Projects	Project Assistance	Fund Use Rate	Project Disbursements	Pace of Construction
\$775.2	\$763.6	99%	\$739.6	97%

As of June 30, 2022, Montana's CWSRF *fund use rate* was 99 percent with just \$11.6 million uncommitted. This the first in seven years that the fund was not overcommitted and remains an excellent fund use rate. Montana uses an aggressive cash flow model to meet current payment requests and considers movement between the Drinking Water State Revolving Fund (DWSRF) and the CWSRF when needed. However, no transfers between funds have occurred for the last four years.

Project demand should remain strong going forward, the SFY23 fundable list had \$194.6 million in potential projects, easily continuing to identify sufficient uses for all CWSRF funds, including the FFY23 grant amount.

The CWSRF spent \$39.0 million in SFY22 on project construction expenses (disbursements) and the *pace of construction* (disbursements divided by total project amounts) remained extremely high at 97 percent during the year. Overall, Montana CWSRF staff manages projects very well.

For another indicator, the \$739.6 in cumulative construction expenses relative to \$247.2 in federal cash draws, kept the cumulative CWSRF *Federal Return* nearly constant, going from 2.91 to 2.91. Both results show a CWSRF that is funding and building projects in a timely manner.

A key component of strategic SRF fund management is the balancing of cash inflows and outflows. The *Ratio of Undisbursed Funds* shows how efficiently Montana's CWSRF is revolving by examining the program's disbursement rate over a set time-period and comparing it to the amount of cash on hand. The ratio is calculated by subtracting total project disbursements (\$739.6 million) from total funds available (\$775.2 million) and comparing this number to the average annual disbursements over the past three years (\$42.6). For the Montana CWSRF, this ratio is 0.84 (years), which shows that this program in SFY22 was using all funds in less than one year, an excellent result.

The unaudited CWSRF financial statements showed the program had \$49.6 million in cash as of June 30, 2022.

Montana CWSRF project milestones accomplishments as of June 30, 2022, as provided in the SRF Data System, are as follows (in \$ Millions).

June 30, 2022 Data (\$ Millions)

- CWSRF Funds Available: \$775.2
- Project Assistance: \$763.6
- Construction Starts: \$764.2
- Project Completions: \$585.9

The Montana CWSRF continues to operate in a high performing manner in funding and completing water quality projects for environmental benefit.

Financial Sustainability

Based on information from the SRF Data System, the Montana CWSRF's *Net Return* increased slightly in SFY22 from \$10.8 million to \$11.4 million. In SFY22, the CWSRF collected a sum of \$6.4 million in interest payments and interest earnings. It also paid \$5.4 million in state match bonds principal and just \$0.3 million in state match bonds interest. The *Net Return on Contributed Capital* (contributed capital

being the sum of federal outlays and deposited state match) is 3.1 percent, an increase from 2.99 percent in SFY21. These calculations do not incorporate the fees the state collects on SRF assistance which are periodically deposited back into the CWSRF (\$1.1 million in SFY22) from loan loss reserve fees and special admin fees, which are used to fund additional water quality projects.

Attached to this report is a table that shows each indicator in further detail for the past five years.

Total Net and Net Interest Margin

Total Net measures the extent by which internal growth is generating additional funding for new projects. This is calculated by taking the total cash inflows generated by ongoing loan and investment activity and subtracting debt service payments from outstanding match bonds. New federal capitalization grants are excluded from this calculation. The measure reflects the amount of new annual project funding that is generated solely from net repayments. For SFY22, the Montana CWSRF's *total net* increased substantially to \$77.6 million (compared to the \$25.3 million average over the previous five years). The total net increased in 2022 due to the repayment of several large short-term loans called Bond Anticipation Notes (BAN), which were provided as bridge funding for loans to be carried long term by USDA Rural Development.

Net Interest Margin measures the percentage rate of return the SRF is generating from its Total Assets through loans and investments after accounting for the interest expenses associated with match bonds. It does not include match bond principal as an expense. Currently, EPA does not have a modeling tool to estimate the state SRF program total assets, so the net interest margin cannot be calculated. However, net interest can be tracked from year to year. Net interest expenses for SFY22 totaled \$6.1 million, which is slightly higher than the \$5.0 million in SFY21 and the previous four years.

Financial Management and Proportionality

The CWSRF shows sound financial health and management. There have been no defaults and all municipal loans are secured by revenues from user charges and/or full faith and credit of the borrowing entities. The total assets (including undrawn Federal grants), based on unaudited financial statements as of June 30, 2022 was \$353.7 million, a three percent increase over the SFY21 total assets of \$343.9 million. Since the CWSRF has deposited and disbursed match prior to drawing federal funds, all four base cash draws listed on page one above was done with a 100 percent federal proportion. Furthermore, the payment requests for the cash draws were for eligible costs and were adequately documented. No costs were questioned, and there were no improper payments.

DNRC has prepared unaudited financial statements on the CWSRF for the year ending June 30, 2022. DEQ has reviewed them. The 2022 financial documents will not be audited. Due to a shortage of auditors and heavy workload, the Montana Legislative Auditor will perform an audit of 2023 SRF financial documents. The program audit will be combined with the statewide single audit for Montana and conducted on a biennial basis. However, the unaudited statements will be completed and sent to EPA each year. The program audit for the biennial period ending June 30, 2022 will also be finished in 2023.

PRIOR RECOMMENDATIONS: There were no recommendations from last year's annual review.

NEW RECOMMENDATIONS:

- (1) EPA recommends that the Financials be audited annually to the maximum extent possible. We

understand that extenuating circumstances with large workloads and a shortage of auditors prevented audit of the 2022 SRF program financials. We recommend the 2023 financial statements be audited, per normal practice.

- (2) EPA understands that the CWSRF program intends to transfer the 2022 CW BIL EC grant funds to the Drinking Water (DW) BIL EC grant. However, for future grant years, EPA recommends the CWSRF program continues to search for qualifying Emerging Contaminant projects. You may wish to reach out to Julie Kinsey, EPA R8 Clean Water Emerging Contaminant Coordinator at Kinsey.Julie@epa.gov or (303) 312-7065 for ideas in identifying potential projects.

The Montana CWSRF assessment has been completed by the SRF Coordinators, Lindsey Phillips and Emily Gillespie, in collaboration with the EPA Region 8 SRF team.

Sincerely,

Benjamin Bents
Manager
Technical and Financial Services Branch

cc: Ms. Anna Miller, Department of Natural Resources and Conservation

Financial Indicator Worksheet (cumulative)
Montana Water Pollution Control SRF
Cumulative Amounts (\$ Thousands)

	June 30 2018	June 30 2019	June 30 2020	June 30 2021	June 30 2022
Fund Use Rate					
WPCSRF Assistance Provided	\$610,364	\$649,721	\$686,837	\$741,743	\$763,604
WPCSRF Funds Available	576,814	621,451	658,653	699,490	775,206
Fund Use Rate	106%	105%	104%	106%	99%
SRF Funds Available:					
Net Capitalization Grants (Minus 4% for Administration)	\$198,450	\$213,462	\$220,931	\$230,137	\$237,516
Total State Match	89,966	94,002	100,028	105,408	107,008
Additional State Contributions	14,380	14,380	14,380	14,380	14,380
Principal Repayments	254,422	276,543	300,840	327,940	394,033
Transfer (to) DWRF	(11,282)	(11,282)	(11,282)	(11,282)	(11,282)
Transfer from DWRF	19,130	22,130	22,130	22,130	22,130
Sustainability	11,749	12,216	11,625	10,777	11,421
SRF Funds Available	576,814	621,451	658,653	699,490	775,206
Project Disbursements	\$571,146	\$611,765	\$647,982	\$700,557	\$739,580
Assistance Provided	610,364	649,721	686,837	741,743	763,604
Pace of Construction	94%	94%	94%	94%	97%
Project Disbursements	\$571,146	\$611,765	\$647,982	\$700,557	\$739,580
Federal Outlays	217,716	224,700	236,463	240,909	247,173
Federal Return	2.62	2.72	2.74	2.91	2.99
Project Disbursements	\$571,146	\$611,765	\$647,982	\$700,557	\$739,580
Funds Available	\$576,814	\$621,451	\$658,653	\$699,490	\$775,206
Overall Flow of WPCSRF Funds	99%	98%	98%	100%	95%
Undisbursed Project Funds	\$5,668	\$9,686	\$10,671	\$19,300	\$35,626
3-year Average Annual Disbursements	49,834	38,001	38,430	43,137	42,605
Ratio of Undisbursed Funds to Disbursements	0.11	0.25	0.28	0.45	0.84
Interest Payments	\$61,104	\$66,573	\$72,365	\$78,360	\$84,752
Interest Earnings	8,761	9,000	9,194	9,197	9,204
Match Bonds Principal Repaid	(43,960)	(48,005)	(53,475)	(59,340)	(64,760)
Match Bond Interest Expense	(14,156)	(15,351)	(16,459)	(17,439)	(17,775)
Sustainability (Net Return)	11,749	12,216	11,625	10,777	11,421
Net Return	11,749	12,216	11,625	10,777	11,421
Contributed Capital	322,061	333,082	350,872	360,697	368,561
Net Return on Contributed Capital	3.65%	3.67%	3.31%	2.99%	3.10%
Annual Measures (from GAO)					
Loan Principal	\$28,591	\$22,121	\$24,298	\$27,100	\$66,094
Loan Interest	5,174	5,469	5,792	5,996	6,392
Investment Interest	151	239	195	3	8
Match Bond Principal Repaid	(4,570)	(4,045)	(5,470)	(5,865)	5,420
Match Bond Interest Expense	(1,246)	(1,195)	(1,108)	(980)	(336)
Total Net	\$28,100	\$22,589	\$23,706	\$26,252	\$77,577
Loan Interest	5,174	5,469	5,792	5,996	6,392
Investment Interest	151	239	195	3	8
Match Bond Interest Expense	(1,246)	(1,195)	(1,108)	(980)	(336)
Annual Net Interest /	\$4,079	\$4,513	\$4,878	\$5,018	\$6,063
(Total Assets Prior Yr. + Total Assets Current)/2*	296,250	307,350	321,250		
Net Interest Margin	1.38%	1.47%	1.52%		